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TAGS: EAID EG
SUBJECT: REFORMING THE USAID PROGRAM IN EGYPT: A DETAILED PROPOSAL

Classified by Ambassador Francis Ricciardone for reasons 1.4 (b) and (d).

¶1. (C) Summary: We propose an overhaul of our economic assistance programs for Egypt that would transfer funds directly to the Government of Egypt conditioned on successful performance on agreed benchmarks aimed at policy reforms. These reform efforts will focus on democracy and governance, health, education, and financial sectors. Managing all (or nearly all) assistance to the GOE via cash transfer mechanism should place more responsibility on Egypt, lower expensive U.S. management costs and directly and explicitly link USG resources to explicit transformational policy goals. Such an evolution offers benefits for both the USG and GOE, but will face stiff resistance from entrenched constituencies of the traditional arrangements. End summary.

The Egypt Assistance Program as an Instrument of Foreign Policy - Historical Features

¶2. (SBU) The U.S. assistance program in Egypt is celebrating its 30th year of accomplishment, the most important of which is its successes both in sustaining Egyptian support for peace with Israel, and in promoting stability in the Middle East.

¶3. (C) This over-arching political objective means that the premise of the program differs substantially from every other USAID assistance program in the world, except for Israel's. Its mechanics differ from all other USAID programs, including Israel's. We convey the assistance to the government of Egypt, not the people or the nation. Until this past year, when the appropriations language was changed to provide direct assistance to Egyptian NGOs, all assistance went to the Egyptian government, for purposes the Egyptian government determined and approved.

¶4. (C) Additionally, we aim, with our economic assistance, to foster economic and domestic policies that will promote democracy, transparency, government and growth. These mechanisms have a mixed record affording policy leverage. The mechanisms are:

-- The cash transfer program: Cash transfers to Egypt are presently operated under a financial sector memorandum of understanding that conditions cash disbursements on successful completion of financial sector policy benchmarks. Several of these benchmarks have been achieved; the current MOU will culminate with the privatization of the Bank of Alexandria, perhaps by January 2007. The cash transfer has been successful in both focusing GOE attention on achievable benchmarks and then encouraging follow-through on politically delicate measures. The benchmarks afford political "cover" to policy makers who need to convince a reluctant political class and skeptical public that, if these difficult steps are

taken, there will be a financial reward for Egypt. In Egypt, policy makers are hypersensitive about this - the official line is the reforms are owned by the GOE and we lend support.

--Commodity Import Program: USAID has historically established Commodity Import Programs for countries with mismanaged foreign exchange allocations and overvalued exchange rates. Thanks in good part to USAID and other USG advocacy, these conditions no longer exist in Egypt. Hence, demand for CIP has dropped and the program has difficulty moving money. We are now phasing it out, with the end FY 2005 funding. The CIP had operated essentially as an unconditioned cash transfer, generating a large local currency account, but affording no transformational diplomacy benefit.

--Project Assistance: Project funding has had a powerful impact on Egyptian life. It has built much of Egypt's roads, bridges, sewage treatment plants, irrigation and telecom system, among others. As a policy tool, however, its record is mixed. We can set priorities but once funding is locked into multi-year technical assistance projects, our leverage over project funding -- that is, its value as a transformational incentive -- evaporates. Denying funds for a project-in-process risks injury to a U.S. firm or organization, waste of the initial funds (the half-built bridge), and loss of jobs associated with the project. These downsides all sustain ongoing projects, regardless of their lack of influence on the GOE's behavior related to larger policy issues.

¶5. (C) Clearly, direct transfer provides the best opportunity to encourage Egypt's reform process. But our ability to leverage policy reform also depends upon where the directly transferred funds end up. In Egypt, reform-minded elements of the cabinet manage much of the national budget

(evidently exclusive of large national security chunks). But, the Ministry of International Cooperation (MIC), a nonreformist element of the Mubarak government, manages USG assistance monies -- cash transfer and CIP local currency counterpart funds -- in an off-budget exercise. (Although we have some approval rights, it would be impossible and even undesirable for us to attempt to follow the local currency through the entire GOE budgetary process.) This arrangement both discourages transparent and responsible budget practices, and undermines the reformers.

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Moving towards a Cash-Transfer Program
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¶6. (U) As we move to a primarily Cash-Transfer Program, we can address shortcomings by addressing: how the dollar transfer is managed; how local currently counterpart funds are managed; how USAID operating expenses are charged to the program; and how policy benchmarks are framed.

¶7. (C) Management of Dollars: We should direct cash transfers to paying down Egypt's eligible (generally USG-origin) external debt plus potential international financial institution debt. If not all cash transfer dollars can be absorbed by debt service, we should simply disburse dollars into an account controlled by the Central Bank for eligible import transactions to the Egyptian public and private sectors. This is how the U.S. manages cash transfers elsewhere in the world. It would save paperwork and program administration costs and force the GOE to adopt international best practices of competing for available dollars at the Central Bank along with other market participants. It would also remove the MIC from deciding which transaction is to be paid for with U.S. funds and eliminate the problem of U.S. contractors lobbying for disbursements even though benchmarks have not been met. Obviously, the MIC will resist surrendering what amounts to both its reason for being, and its principal source of funds. But, PM Nazif and the rest of his cabinet stand to gain commensurately. With Mubarak's support, such a shift is conceivable over time.

¶8. (C) Management of Local Currency: Currently, the Ministry of International Cooperation decides which GOE programs will receive local currency counterparts for U.S. cash transfer funding. This is another mechanism arrangement which has positioned the Ministry of International Cooperation as an alternative budget center within the GOE and given MIC significant clout with other ministries. Activities that do not receive funding in the first budget review managed by the reformist economic cabinet can now come around the back door and try to persuade the MIC. Both the IMF and World Bank have urged us to put an end to this alternative funding stream. Economic ministers also support this objective. Again, we would need to persuade both PM Nazif and Mubarak to take on the MIC and its entrenched constituencies.

¶9. (U) Under a reformed cash transfer program, no local currency should be generated. The implicit resource transfer will then travel through the regular budget in the same manner as other sources of budget financing, and U.S. funds will support a much more transparent, responsible budget process rather than thwart it. The USG would ask, as part of the sectional cash transfer agreements, that the Ministry of Finance allocate sufficient resources to line ministries to implement agreed-upon reforms.

¶10. (SBU) Local Currencies for USAID Operating Expenses: The costs of managing the USAID have traditionally been funded from program local currency generations. The GOE approves USAID's annual budget request out of the local currency account. If local currency generations are eliminated as a feature of the program, we will need to identify a new way to cover the costs of managing the USAID program. This has the advantage of eliminating the unseemly practice of relying on Egyptian government approval for our operating costs. It will also reduce requests from the GOE for program funds to hire more public sector employees to administer USAID-related programs.

¶11. (SBU) We propose seeking a U.S. legislative solution whereby appropriate language authorizes a fixed percentage of the Egypt assistance program dollar funding to cover its operating costs. There are precedents for this approach, for example for USAID OE costs relating to the Andean Counterdrug Initiative. Based on recent estimates of the cost of running USAID/Egypt in future years, the proposed appropriations language should authorize "up to three percent" of the Egypt program dollar funding for OE. For GOE costs associated with overseeing USAID programs, the USG should advocate that these costs be budgeted by the GOE in the national budget and funded by the GOE using the cash transfer resources that

supplement national revenues. This step should hold strong bipartisan appeal.

12 (C) Policy Benchmarks: We propose releasing funds to the GOE based on its performance under the agreed policy benchmarks. Drafting achievable benchmarks that push Egyptian ministries towards wise policies will be the central challenge of this exercise. The financial sector MOU is a successful model. Still, the Egyptian side faces a steep learning curve and Minister of International Cooperation Aboulnaga is not yet committed to this approach.

¶13. (SBU) Successful benchmarks should:

-- be explicit, yet discreet;

-- achievable within two-years;

-- allow for partial success and incremental payments along the way;

-- avoid target dates for specific elements, and simply include a global terminal date for requesting disbursement.

-- be easily recognizable as completed (or not); If

measurement is required, the measures should be agreed in writing before the MOU is signed.

-- focus on clear priorities.

Recommendations for Reform of Egypt Program

¶14. (SBU) Summing up, we recommend that we:

-- Reform the Egypt program to provide most assistance via a cash transfer mechanism;

-- Manage cash transfer dollar disbursements through the Central Bank, as part of the normal foreign exchange allocation system (following USG requirements as practiced elsewhere in cash transfer programs);

-- Generate no local currencies;

-- Fund USAID operating costs in Egypt mission by an allocation in the pending appropriation bill. The language should be based on a percentage of the total program ("Up to three percent"). USAID/Egypt's annual operating budget should no longer be subject to GOE review.

-- Make policy benchmarks triggering program disbursements significant, few, and measurable. We should apply a terminal date for overall program disbursements contained in the cash transfer agreement; benchmarks should not carry specific dates for completion.
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